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May 29, 1996

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Office of the Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

RE: In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, NPRM adopted April 19, 1996, Released April 19, 1996.

Office of the Secretary:

Attached are an original and sixteen (16) copies of Texas Statewide Telephone Cooperative, Inc.'s (TSTCI's) Reply Comments in this cause.

Copies of these comments have been sent to Janice Myles of the Common Carrier Bureau and to International Transcription Services, Inc.

Please call if you have any questions regarding the attached.

Sincerely,

Gary L. Mann

Gary L. Mann
Authorized Representative

GM/dz

Attachments

No. of Copies rec'd O+16
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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)))	CC Docket No. 96-98

REPLY COMMENTS OF
TEXAS STATEWIDE TELEPHONE COOPERATIVE, INC.
(TSTCI)

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Chairman, Regulatory Committee

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BEFORE THE
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In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)))	CC Docket No. 96-98

REPLY COMMENTS OF
TEXAS STATEWIDE TELEPHONE COOPERATIVE, INC.

Texas Statewide Telephone Cooperative, Inc. (TSTCI) files this reply to certain comments of other parties in this docket.

I. Cox Communications Inc.'s (Cox) proposal of an upper and lower bound on rates is without logic and would preclude an incumbent telephone company from recovering its cost of service.

Although Cox confuses costs and rates, it proposes a lower bound for rates equal to the long run incremental cost (LRIC) and an upper bound equal to "bill and keep."[1] The basic flaw in Cox's proposal is that the upper bound may be less than LRIC, the lower bound. Bill and keep arrangements do not recover costs unless certain prerequisites are met. First the quantity of usage exchanged between the two firms must be identical. Second the cost for terminating a minute of use must be the same for both firms. The probability of these events occurring is extremely low, approaching zero. Cox wants bill and keep because it alleges that such an approach provides an equal opportunity for new entrants to compete.[2] There is absolutely no evidence that bill and

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[1] Cox's comments at p. 25.

[2] Cox states that bill and keep has been used for years by local exchange telephone companies. Cox's comments at p. 36. What Cox fails to recognize is that these local exchange companies are "jointly providing service" whereas Cox and others are competing with the local

keep is economically efficient as purported by Cox. Cox merely wants the incumbents to subsidize its entry into the telecommunications market. Cox is a prime example of a nationwide company with resources that are significantly greater than those of the typical rural local exchange telephone company. It is an unregulated monopoly providing service to over 5.1 million homes in the United States and holds a significant interest in another industry giant, Teleport Communications Group, Inc. Both have filed comments in this cause. Time Warner Communications Holdings, Inc. (Time), another large nationwide corporation with relatively unlimited resources, also wants bill and keep.[3] TSTCI does not oppose bill and keep as a negotiated option under § 252; rather, TSTCI opposes bill and keep as a mandated ceiling because it does not allow the incumbent to recover its costs.

II. The local exchange companies must be permitted to recover the embedded costs that result from regulatory mandates to provide universal service.

At page 26, Cox attempts to explain a difference between LRIC and TSLRIC. It states that TSLRIC "include all the costs caused by a decision..." while LRIC "recognizes only the forward looking incremental costs of specific changes in output." Thus, according to Cox there is no difference between the two, as both include the incremental (additional) costs of a decision which causes a change output. Clearly, this is a distinction without a difference. Both Cox and

exchange companies for services provided in their certificated areas.

[3] Time's Comments at p. 92.

Time fail to cite any case, economic treatise or literature for its analysis of TSLRIC.[4] Of course, it could not do so since TSLRIC is not recognized by economists as a measure of cost that has economic value. This allows parties to define TSLRIC in any manner that serves their immediate need.

Unlike the local exchange company franchises, neither Cox's nor Time's monopolies require that they serve all potential customers within its certificated areas. Also unlike small rural local exchange telephone companies, Cox and Time do not serve rural customers in remote areas at uniform rates.[5] Local exchange companies are required to serve all customers within their certificated areas.[6] This requirement creates an embedded investment (an embedded investment mandated by the regulators) that the local exchange companies must recover above its LRIC. Accordingly, the Commission should allow rates that recover this embedded investment regardless of the cost standard used. Contrary to Time's assertion, the Act allows the Commission to consider embedded costs.[7]

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[4] Other cementers have also espoused the alleged virtues of TSLRIC without citing any recognized authority or economic treatise supporting TSLRIC as a standard for any economic purpose. *See* Comments of the National Cable Television Association, Inc. at p. 49.

[5] It is unlikely that Cox serves any rural high costs customers. Instead it is able to pick an choose it customers (even though it may be a monopoly provider in an area) to obtain a high return on its investment.

[6] A telecommunications utility holding a certificate of convenience and necessity "shall render continuous and adequate service within the area.... [and] has provider of last resort obligations." Tex. Rev. Civ. Stat. Ann. art. 1446c § 3.258(a) (Vernons 1995) (PURA95).

[7] Time argues that because the § 252 standard is costs but not rate-of-return or rate based proceeding that embedded costs are precluded from consideration. Time comments at p. 51. While rate-of-return and rate based proceedings may be based upon embedded investments, the

III. AT&T's attempt to provide credibility to TSLRIC is misguided.

AT&T has long recognized that there is no credible authority or economic treatise supporting TSLRIC as a standard for any economic purpose. Therefore, AT&T has tried to salvage its claims by attaching to its comments an affidavit signed by William J. Baumol, Janusz A. Ordover and Robert D. Willig, three noted economists supporting TSLRIC as a standard for pricing. Of course, these economists cannot contradict their previous writings and teachings. The specific principles listed at page 9 of the affidavit are the same principles that could be used to describe LRIC. Although the entire demand of all uses and users is deemed appropriate under principle (4), only the additional costs caused are appropriate under principle (3). This is consistent with the development of LRIC.

The one principle that makes no sense is principle number (2) which requires the incumbents to ignore where they stand today in determining the most efficient, cost-minimizing approach. No competitive firm is prohibited from considering today's factors in pricing its services to the public. It makes common sense to consider where you are today in determining the additional costs that might be imposed to serve additional demand. If it is less costly to completely replace facilities, then replacement would be the best choice for the firm to make. If it is less costly to provide the same service by adding to existing facilities, then good business judgment dictates that option over a complete facility replacement.

In MCI Communications Corp. v. American Tel. & Tel. Co. "MCI also contended... that

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terms are not synonymous. Rate-or-return and rate based proceedings may also be based upon a fair market value standard.

AT&T was obligated to provide it with local distribution facilities at the same rate at which AT&T provided such facilities to Western Union.... AT&T disagreed, claiming that the contract... did not reflect AT&T's current costs, and that the price charged to MCI for local distribution facilities should be set so as to recover AT&T's costs on a current basis."(emphasis added). [8] Obviously, AT&T changes its view whenever it hopes to benefit, and creates smoke to promote its own interests.

The important fact for the Commission to remember is that the regulators mandated that the incumbent local exchange companies provide facilities to serve all potential customers in their certificated areas. If these incumbent local exchange companies had been able to pick and choose their customers, much as the new competitors are able to do, they might never have served the high cost rural customers - at least not at the same uniform rates as required by the state regulators. This social decision imposed costs upon the local exchange companies that their competitors do not incur. Because of the obligations to serve placed upon the incumbent local exchange telephone companies, they should be allowed to earn on these investments. TSTCI respectfully requests that the Commission consider these costs as relevant when determining how services are priced to resellers and the new competitors entering the market without such obligations.

[8] MCI Communications Corp. v. American Tel. & Tel. Co., 1982-83 *Trade Cases* Par.71,359 (7th Cir. 1983).

IV. Cable television providers should be required to unbundle their facilities to promote competition.

Cox argues that the Commission should only require incumbent local exchange companies to unbundle their facilities.[9] Cox and the other monopoly providers of cable television service have facilities available for competitors to use as an alternative to those of the incumbent local exchange telephone companies. To truly promote equal and fair competition, all players should play under the same rules. Moreover, as an alternative supplier of facilities the promotion of competition necessitates that cable television providers unbundle their facilities under the same rules as the local exchange telephone companies. Even Cox admits that others may want to use its facilities.[10] Only if others are required to unbundle and make their facilities available on a non-discriminatory basis can true competition occur.

V. The efficient component pricing rule is a proper consideration for the Commission in pricing unbundled and collocated services.

Contrary to Time's allegation at page 56 of its comments, the efficient component pricing rule is appropriate for pricing unbundled and collocated services. Time fails to quote any economic authority to the contrary. The issue is raised when a local exchange telephone company provides a service, and a component of the service is also used by a competitor to provide a competing service. The question is how should the component be price. According to Professor Baumol, the price of the component should include all marginal costs, including the opportunity

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[9] Cox's comments at p. 48.

[10] Cox's comments at p. 58, note 115.

costs incurred in supplying the product.[11] Consider the following example: a service has two components, A-B and B-C. The incremental cost of A-B is $3.00 and the incremental cost of B-C is $3.00. The price charged for the service A-C is $10.00, giving the supplier a $4.00 profit. If the supplier provides component A-B to a competitor, the efficient component price to the competitor should be $7.00 which is the sum of the previously identified marginal cost of A-B plus the opportunity cost (the revenue foregone by not supplying the entire piece).

Professor Baumol says that efficient component pricing promotes economic efficiency.[12] Consider the above example: if the competitor could supply the B-C leg for $2.00, then it could sell in the retail market for $9.00 and thus would capture the market. Thus, the most efficient supplier of the B-C leg captures the market. Such a pricing approach is relevant to the pricing of unbundled and collocated services.

Professor Baumol appears to contradict his own treatise in the AT&T affidavit wherein he states "[t]he existing structure of end-user prices for local telecommunications is not appropriate as a baseline for ECPR or any other pro-competitive purpose; it is utterly inconsistent with the competitive policies of the 1996 Act." But in his treatise, Professor Baumol titles his Chapter VII as "On Public Interest Pricing of Inputs Sold to Competitors."[13] He further states that "the average incremental cost must include all <u>opportunity costs</u> incurred by the supplier in providing

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[11] Baumol, <u>Deregulation and Residual Regulation of Local Telephone Service</u>, 71 (AEI Studies in Telecommunications Deregulation presented March 3, 1993).

[12] Baumol, *supra* note 10, at 76.

[13] *Id.* at 70.

the product."[14] Addressing local loop prices he states "[t]he setting of a price for access to the local loop in telecommunications is precisely analogous to the setting of the rental fee for trackage rights or the pricing of any other product component under comparable circumstances."[15] TSTCI believes that Professor Baumol was correct in his first analysis, that efficient component pricing is relevant to competitive situations, including the pricing of unbundled and collocated services..

VI. Interconnection agreements between non-competing neighboring local exchange carriers are not subject to Sections 251 and 252.

Contrary to Time's assertion at page 63 of its comments, Congress never intended that existing agreements between non-competing local exchange carriers be subject to the requirements of §§ 251 and 252 of the Act. Congress' intent under the Act is explained under its Joint Explanatory Statement clarifying § 252:

> Nothing in this section should be construed as requiring any parties to renegotiate any agreement currently in existence unless the new Commission regulations under this section require such negotiation.

The local exchange telephone companies have been jointly providing extended area service (EAS) for years under rates and regulations found to be in the public interest by the state public utility commissions and the state legislatures.[16] The Commission should not now require that those agreements be renegotiated. Such agreements are between jointly providing carriers and not between competing carriers. To require the renegotiation of such agreements would cause rates

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[14] Baumol, *supra* note 10, at 71.

[15] *Id.* at 75.

[16] See PURA95 §§ 3.304 and 3.308 regarding EAS and other toll free calling areas.

for local calling areas to change and would frustrate the public interest findings of the state commissions and legislatures.

Respectfully submitted,

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